

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:3 PLR-139743-04

Date:

September 29, 2006

Company:

LLC:

Shareholders:

State:

a:

b:

c:

Dear :

We received your letter dated July 2, 2004, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code that the termination of Company's S corporation election was inadvertent. This letter responds to that request.

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FACTS

Company was incorporated on a under the laws of State and elected under § 1362(a) to be an S corporation effective on a.

Shareholders transferred all their Company shares to LLC, an ineligible shareholder, on b. Company management and internal accounting staff executed the stock transfer. Company's federal tax return for the year of transfer was prepared by outside accountants. Company was unaware that it had an ineligible shareholder until a new outside accountant identified the issue on c. Company promptly submitted this request for inadvertent termination relief.

Company and Shareholders represent that they had no intention of terminating Company's S corporation election. Each member of LLC is an eligible S corporation shareholder, and each reported on his federal tax return his prorata share of Company income, gain, loss, and deduction from b to the present. Company, LLC, and the members of LLC agree to make any adjustments during the termination period (consistent with the treatment of Company as an S corporation) as might be required by the Service.

LAW

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments

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(consistent with the treatment of the corporation as an S corporation) as might be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a nonresident alien).

CONCLUSION

Based on the facts and representations submitted by Company, we conclude that the termination of Company's S corporation election due to the transfer of Company stock to LLC, an ineligible shareholder, was inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will continue to be treated as an S corporation from b, and thereafter, unless Company's S election otherwise terminates under § 1362(d).

As a condition for this ruling, LLC must not be treated as a shareholder for any time it held Company shares. Accordingly, for the time during the termination period that LLC did hold Company shares, the members of LLC shall be treated as shareholders of Company, directly owning Company stock they owned indirectly through the LLC, as represented by their LLC ownership percentages.

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Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding Company's eligibility to be an S corporation.

Under a power of attorney on file with this office, we are sending the original of this letter to you and a copy to Company.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosure: copy of this letter
copy for § 6110 purposes

cc: